Democratic governance and economic enterprise:  
a story of two Acts

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Very draft. Quote with caution!

Introduction

Participatory governance or democratic innovation is an area of growing policy and academic interest (Smith, 2009; Warren, 2009). But the overriding attention in this literature is on the role and activities of public authorities and civil society. There is almost no mention of participatory governance within economic enterprises. Why mainstream political science and democratic theory has been relatively silent on the topic of economic democracy is a pertinent question given the extent of corporate mismanagement and incompetence and rising economic inequalities – and the well understood link between economic and political inequality.

This paper sketches the different ways that democratic engagement is conceptualized in the governance of economic enterprises. The democratic organization of economic enterprises can vary dramatically, with very different actors afforded agency within governance structures. The simplest democratic forms are captured under the distinct models of ‘shareholder control’ and ‘workers’ control’. In both cases one specific group is empowered and these organizational forms characterize very different visions of economic enterprise. In between these two models are a range of more complicated democratic structures that have been captured under terms such as ‘stakeholder participation’, ‘social economy’ and ‘associative democracy’. An attempt is made to make sense of this variety of forms and their democratic implications.
The second half of the paper provides a brief overview of the current policy trajectory in the UK as it shapes democratic governance and economic enterprise. The current policy and regulatory framework can be understood in relation to two Companies Acts in 2004 and 2006. While there is rhetorical encouragement for stakeholder and mutual organization, the detail of these Acts and subsequent policy developments suggest that democratic governance remains of relatively little policy interest.

**Democracy and economic enterprise: competing models**

Democracy has been connected to the practice of economic enterprises in a number of ways. The form that tends to come to mind is that of workplace democracy, with workers’ empowered to participate in corporate governance. But this is not the only way in which democracy has been conceptualized in relation to economic enterprises; workers’ are not the only group of actors that have been considered as the agents of democratization. If workers’ control sits at one end of the economic democracy spectrum, then shareholder control sits at the other. Here the concern is with empowering owners of public corporations to rest control from managers. But somewhere in between these relatively simple models of corporate governance (empowerment of workers or of shareholders) we find more complex accounts of democratic engagement which empower a plurality of actors and present an alternative understanding of the function of corporations: stakeholder participation, social economy and associative democracy being pertinent examples.

I. Worker’s control

The cause celeb of economic democracy is the workers’ cooperative. Like other forms of cooperative and mutual, members – in this case workers – are owners of the enterprise and have equal participation rights. A basic democratic relation of governance – one member, one vote – is a necessary condition. Within the UK, the

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1 Sections of the analysis that follow draw on Smith and Teasdale (2012)
Industrial and Provident Society (IPS) (of which workers’ cooperative is one type) dates back to 1852; itself derived from earlier Friendly Society legislation (1834).

The democratic argument for workplace democracy is most commonly associated with Pateman’s theory of participatory democracy (1970). The hierarchical and authoritarian structures of the traditional workplace undermine autonomy and any sense of political efficacy on the part of workers. As Pateman argues, ‘there is a continuing interrelationship between the working of institutions and the psychological qualities and attitudes of individuals interacting with them’ (Pateman, 1970: 22). In contrast, through the structures of workplace democracy, workers learn to participate in democratic governance, which then has a spill-over effect on the vibrancy of broader democratic structures and practices (see also Cohen, 1989).

for a democratic polity to exist it is necessary for a participatory society to exist, i.e. a society where all political systems have been democratised and socialisation through participation can take place in all areas. The most important area is industry; most individuals spend a great deal of their lifetime at work and the business of the workplace provides an education in the management of collective affairs that is difficult to parallel elsewhere. (Pateman, 1970: 43)

Dahl (1985) offers a slightly different defense of workers’ cooperatives, arguing that just as authoritarian relations cannot be justified in the governing practices of the state, neither can they be justified in other forms of cooperative association, in this case economic enterprises. Adopting a republican perspective, Breen (2015) argues that only through the democratic workplace can we realize self-determination.

Workers’ cooperatives – and cooperatives and mutuals more generally – remain a relatively marginal economic form. The practice in the UK in the 1970s for workers to takeover bankrupt firms, promoted by the then Labour government, was generally a failure and arguably clouded views on the possibility of workplace democracy. However, these failures were typically not because of the ownership and
management structure, but because of underlying commercial weaknesses of the firms that had been taken over.

There are however structural barriers within the economy that result in workers’ cooperatives remaining a niche form of organization. As Miller argues, the contemporary market ‘discriminates in favour of those who prefer the authority structure of the capitalist firm’ (Miller, 1981: 327-8). Economic enterprises that aim to promote ‘group orientated desires’ (such as democratic participation, equality at work and environmental protection) find themselves disadvantaged in the market (and in open competition for procurement of public services) with those that aim to satisfy only ‘private desires’ such as shareholder return on investment. ‘Rather than being a neutral device, the market discriminates against certain preferences, such as those for cooperative modes of organisation’ (ibid: 324). If cooperative forms of governance are to thrive within economic enterprises, the state must ‘facilitate alternative modes of association, or change the financial terms on which different institutions compete’ (ibid: 328).

II. Shareholder control

At the opposite end of the governance spectrum sit arguments for ‘shareholder power’ (Bebchuck, 2005) and ‘shareholder activism’ (Goranova and Verstegen Ryan, 2014) that are on occasion explicitly referred to as ‘shareholder democracy’ (Parkinson 2012). Such arguments have gained traction in light of recent failures in corporate governance (Fairfax, 2009) and the increase in institutional investors in capital markets (Goranova and Verstegen Ryan, 2014). Many democrats will baulk at the use of the term democracy in this context, particularly since share ownership clearly violates the principle of political equality: the number of shares equates to voting power. It is a reasonable concern that enhanced shareholder democracy (read shareholder power) will simply enable the dominance of those interests with larger shareholdings over others.
Terms such as shareholder democracy and power are used, however, to capture arguments which seek to rebalance the exercise of power within corporations, in favour of shareholders. An increase in shareholder voice within companies is taken to be critical to increase shareholder value, understood in limited economic terms, or more broadly to improve social and environmental performance. While in legal terms shareholders’ interests are primary, their realization is complicated by shareholders dependency on management for accurate information about corporate performance, while the sheer number of shareholders and diversity of interests generates considerable collective action problems (Stout, 2007; Fairfax, 2009; Parkinson, 2012).

There is a wide recognition that different regulatory regimes affect the balance of power between shareholders and managers (Roe, 1994; Brunner, 2013; Driver and Thompson, 2002), with the UK taken to be more orientated towards the interests and power of shareholders than the US (Armour et al., 2003). Given this, it is unsurprising that much of the literature presenting corporate law reforms in favour of shareholders focus on US corporate practice. Reforms proposed by the Committee on Capital Markets Regulation (2006) are mainly based on the justification that they lead to improved firm value and efficiency, but there is also the sentiment that the relative lack of power vis-à-vis management is problematic in itself (Hill, 2010). And in the European Community, the Draft Shareholder Rights Initiative has sought to strengthen shareholder voting rights across borders (Nolan, 2006). Policy interest in reforms which empower the shareholder voice has however waxed and waned, often in response to corporate scandals (Fairfax, 2009), but also because the arguments for and against strengthening shareholders’ position in corporate governance remains hotly contested.

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2 The Committee on Capital Markets Regulation, established in 2006, is a non-partisan research organization which produces policy reports on US financial regulatory reform, led by the industry representatives and academics from finance, investment, business, law and accounting.
III. Stakeholder participation

If the participation of, and control by, workers and shareholders in the governance of economic enterprise represent two diametrically opposed visions of economic democracy (with very different accounts of who are the democratic agents), there is a rather complex assortment of ideas for democratic economic arrangements that sits somewhere between these two poles.

‘Stakeholder participation’ in economic enterprise was popularized in the UK through the stakeholder philosophy of New Labour (in particular the arguments for stakeholder capitalism of Will Hutton; see Prabhakar, 2003). The term ‘stakeholder’ was first used in relation to economic enterprises in a 1963 Stanford Research Institute report to describe the myriad of actors – not just the shareholders – who are critical to organisations and their success (Parmar et al., 2010). Freeman (1984) developed his highly influential stakeholder theory as a means of understanding three interrelated business problems: (a) how value is created and traded; (b) tensions between ethics and capitalism; and (c) the managerial mind-set and how managers think about value creation and business ethics (Parmar et al., 2010). Freeman argues that his theory replaces the notion that managers have a duty to stockholders with the concept that managers bear a fiduciary relationship to stakeholders. Stakeholders are those groups who have a stake in or claim on the firm...each of these stakeholder groups has a right not to be treated as a means to some end, and therefore must participate in determining the future direction of the firm in which they have a stake (Freeman, 2002: 39).

While proponents of stakeholder democracy argue that ‘input in the decision-making process of the organization’ (Phillips et al., 2003) is necessary to realize procedural justice among stakeholders, there is a notable lack of definition of what ‘input’ entails and the degree of control stakeholders ought to be granted.
Parmar et al. (2010) assert that stakeholder theory does not require changes in legislation. However, others argue that corporate law, and primacy of shareholders within the law, constrains the realization of stakeholder influence. Given this, changes to corporate law have been suggested, such as the strengthening of legal responsibilities of the firm towards its stakeholders (Hendry, 2001), or in adapting other laws relevant to public corporations in order to encourage a stronger stakeholder orientation. Driver and Thompson (2002) suggest, for example, that adaptations to corporate tax law could be used as a way of incentivising a stakeholder orientation in public corporations. In addition to the governance arrangements which already represent the interests of particular groups, such as Works Councils, Turnbull (1994) and Driver and Thompson (2002) suggest that further structures, such as a ‘corporate senate’ could function as a place where ‘established interests could be finally bought together into a decision making or advisory arena alongside the other (stakeholder) interests’ (2002: 125).

Comparative analysis suggests that different regulatory regimes and cultures are more receptive to stakeholder interests, highlighting differences between Anglo-American corporate governance arrangements and those found in other countries, including Germany and Japan which, although quite different, share a stronger emphasis on employee interests and their involvement in decision-making (Driver and Thompson, 2002; Aguilera and Jackson, 2010).

A prominent criticism of stakeholder theory is that it fails to specify the single objective of the firm, making management decision-making – which must weigh up the competing stakeholder interests – more complex and success more difficult to measure (Jenson, 2002). Certainly, stakeholder theory operates at a level of abstraction that offers very little practical guidance on (a) how the different stakeholder interests should be judged as more or less relevant; (b) how these interests are integrated into decision-making in practice; and (c) how the broad notion of stakeholder value could be measured.
IV. Associative democracy and the social economy

Associative democracy, in the hands of Hirst (1994), is a vision of economic and welfare governance with the primary institutions being ‘voluntary and self-governing associations’. In engendering solidarity and trust, associationalism aims to strike a balance between cooperation and competition. His critique of dominant forms of corporate ownership and control resonates with that of advocates of workplace democracy: the impact on the broader political process and the lack of control that individuals and communities have over large parts of their lives and surrounds. But for Hirst it is not only workers who should be empowered in the governance of economic enterprises: participation should not be limited to only a single category of stakeholder (ibid: 142). Self-governing associations operating in the public and private spheres must be accountable and democratic, but the specific structure of accountability and democracy is likely to be plural and diverse. Beyond this rough caricature, he gives very little detail of the form of organization he has in mind. In some ways this sounds close to ‘stakeholder participation’ – and Hirst does use the term stakeholder in places. What is clear though is that he is looking for significant structural reform to the corporate form, beyond ‘the republic of shareholders’: ‘companies need to be encouraged by public policy to evolve into self-governing associations that are sufficiently representative of their stakeholders to continue to enjoy the privileges of corporate status’ (ibid: 146).

Smith and Teasdale (2012) argue that the institutional forms that constitute associative democracy are already present within the ‘social economy’. The term *Economie Sociale* originates in France where it has a specific legalistic meaning that distinguishes the social economy from state and market and does not translate well into the Anglo-American context. Defourny and Delveterre offer a much-quoted definition:
The social economy includes all economic activities conducted by enterprises, primarily co-operatives, associations and mutual benefit societies, whose ethics convey the following principles:
1. placing service to its members or to the community ahead of profit;
2. autonomous management;
3. a democratic decision-making process;
4. the primacy of people and work over capital in the distribution of revenues. (Defourny and Delveterre, 1999: 16; see also CIRIEC, 2000: 11)

Similarly, Moulaert and Nussbaumer argue, ‘the social economy is that part of the economy... that organises economic functions primarily according to principles of democratic co-operation and reciprocity’ (Moulaert and Nussbaumer, 2005: 2079).

Such definitions suggest that a broad range of organisational forms fall under the definition of the social economy / associative democracy that empower different democratic relationships between actors such as workers, shareholders, volunteers, trustees, members, users, customers, funders, contractors and the wider community. These would include, for example, social and community enterprises, building societies, charity trading arms, consumer retail societies, credit unions, fair-trade companies, housing associations, intermediate labour market companies, local exchange trading schemes, marketing cooperatives, mutual cooperative companies, social firms, time banks, voluntary enterprises and workers’ cooperatives (Pearce, 2003: 29). Thus the social economy extends from workers’ cooperatives to some of the more radical proposals of stakeholder democracy. There is the usual challenge with nomenclature here, as some advocates of cooperative and mutual structures use the term ‘stakeholder democracy’ to describe such organizational forms (Turnbull 1994; 1996).

Another confusion is that in the UK (unlike France and other parts of mainland Europe), available legal forms do not necessarily require democratic modes of organization: it is only IPS that places such a requirement (Smith and Teasdale 2012). We cannot simply ‘read-off’ membership of the social economy from legal
structures. The recent emergence of the social enterprise legal form, ‘community interest company’ (CIC), thus causes further confusion, an issue we pick up in the following section.

Social economies vary cross-nationally by size and by shape, the result of broader social, political and economic patterns (Salamon and Anheier 1998; Teasdale, 2012). While there are real challenges in data collection because of the different legal and regulatory structures at play, the most recent study suggests that in the EU ‘over 11 million people, equivalent to 6.7% of the wage earning population of the EU’ work in social economy organisations (Monzon and Chavez, 2008: 569).

**Economic democracy in the UK – the policy landscape**

The current regulatory and policy landscape of economic democracy in the UK was primarily shaped during the New Labour regimes. Two Companies Acts – 2004 and 2006 – provide the relevant regulatory framework. At first sight, the 2004 Act introduces a new legal form for social enterprise that will promote the social economy and associative democracy; two years later, the 2006 Act establishes the basis for a stakeholder conception of democracy within the traditional firm. But in both cases the interpretation would be somewhat misleading.

**I. Companies (Audit, Investigations and Community Enterprise) Act 2004**

The 2004 Act provides the legislative basis for a new legal form: the Community Interest Company (CIC) and a CIC Regulator. This was followed by the establishment of a Social Enterprise Unit within government, leading to claims that the UK had one of the most developed institutional support structures for social enterprises in the world (Defourny and Nyssens, 2008; Nicholls, 2009). At face value this is a significant step towards establishing new democratic practices within economic enterprises. But the UK form of ‘social enterprise’ needs to be distinguished from the broader idea of the social economy at play in mainland Europe where these new entrepreneurial and risk-taking social enterprises still have a ‘participatory nature’:
‘Representation and participation of customers, stakeholder orientation and a democratic management style are important characteristics of social enterprises (Defourny, 2001: 18). The UK (not for the first time) has followed a US rather than European model. CICs must have a social purpose and an asset lock designed to ensure assets are retained for the benefit of the community. However, the CIC legislation is flexible in permitting a wide range of governance forms and organisational structures: while some CICs choose to enact democratic structures of one kind or another, there is no explicit requirement for democratic governance. As of yet, we lack substantial evidence for how many CICs have chosen to adopt democratic structures and practices.\(^3\) Much can be read into this policy priority: risk-taking and entrepreneurial activity promoted over and above democratic governance.

Further confusion abounds because of the way in which both the Labour and Coalition administrations have used the term ‘mutualism’ to capture the activity of socially-minded enterprises, be they founded under IPS, CIC or some other legal form. Both Labour’s ‘Right to Request’ programme, replaced by the Coalition’s ‘Right to Provide’ and supported by the creation of the Mutuals Information Service in the Cabinet Office, led to the creation of public sector social enterprises and mutuals. The ‘Right to Challenge’ introduced under the Localism Act 2011 extended these powers to spin-out public services into the third sector. While the term ‘mutual’ is typically used in this policy context, it is the social enterprise CIC form that is more actively promoted by government and favoured by these new organisations, ‘approximately 92 percent of Right to Request organisations being established as CICs’ (Hazenberg and Hall, 2013: 18). Again, we can see that UK policy opens up space for democratic forms of governance – this time in the spinning-out of public services – but this space is permissive and the establishment of democratic governance remains a choice for those founding and/or running the organisation.

\(^3\) A significant piece of research would be to understand the determinants of when a CIC adopts democratic governance and the shape of those practices.
II. Companies Act 2006

Stakeholder ideas clearly influenced the development of the 2006 Act. Villiers argues that the Act followed the Company Law Review Steering Group\(^4\) (2001) in its understanding of ‘enlightened shareholder value’ which it defined as ‘a proper balanced view of the short and long term; the need to sustain effective ongoing relationships with employees, customers, suppliers and others as well as to consider the impact of its operations on the community and the environment’ (Villiers, 2010). This understanding informs the duties outlined in S172 of the Act, which requires company directors to act in the interests of wider stakeholders, such as employees, suppliers, customers, the community and also the environment. However, according to Villiers, these stakeholder interests are only to be accounted for in order to ‘promote the success of the company for the benefit of its members (i.e. shareholders) as a whole’ (ibid: 10). Stakeholder control in the public corporation, as specified in statute, is therefore limited. Managers have discretion over whether to acknowledge stakeholder interests and these interests are only seen as legally valid if, in meeting them, they contribute to the maximisation of shareholder value. In the Act shareholders’ interests retain primacy (Keay, 2007). As Collinson and colleagues note in their interviews with individuals involved in the Company Law Review (CLR):

> the more widely shared understanding was that, while the wording acts as reminder about the interests of the other stakeholders, their interests should be taken into account only in order to induce them to contribute to the overriding objective, which is to maximise shareholder value. The central intention of the CLR, subsequently enshrined in CA 2006, is that shareholder is sovereign. (2011: 41-2)

Stakeholder influence in public corporations is thus limited by shareholders’ interests and their understanding of value and its maximization.

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\(^4\) The Company Law Review Steering Group (CLRSG) launched in 1988 and producing a report in 2001, addressed the ‘scope’ of companies (that is, in whose interests they should be run) and was part of the process culminating in the Companies Act 2006 (Collinson et al., 2011)
The Companies Act 2006 strengthens the hand of those arguing for enhanced shareholder participation, codifying, for example, shareholders’ right, at the general meeting, and by a special resolution of the shareholders, to initiate changes to the corporation’s constitution (Hill, 2010; Parkinson, 2012). Additionally, UK shareholders have the right to increase or reduce the capital and the issuing of shares; the purchase or redemption of shares; the right to resolve that the company should be wound up; and the right to sanction the payment of dividends. They also have the right to remove directors, and to confirm transactions in which directors have a conflict of interest (Parkinson, 2012). The extent to which these changes materially affect the balance of power between shareholders and directors/managers is an open question. But they do appear to have opened up more space for shareholder activism, be that from civil society groups aiming to disrupt and redirect the social and environmental activities of public corporations or activist hedge funds looking to promote better management practices (as has happened in the US – see The Economist, ‘An Investor Calls’, 2015).

**Conclusion**

Just as there are multiple forms of democratic innovation (and multiple analytical approaches to capturing this diversity) within the traditional political realm (Fung, 2003; Smith, 2009), we should not be surprised that forms of democratic governance vary within the economic realm. One of the challenges we face is mapping the various existing and potential forms: in this paper we have attempted to navigate theory and practice with shareholder and workplace control at two ends of a spectrum and more pluriform stakeholder, associative and social economy models somewhere in between. Much more work needs to be done to clarify the contours of this space, both empirically and conceptually. Creating such a map will hopefully help us to better interpret the existing policy and regulatory landscape and future trajectories.
Democratic governance in economic enterprise has not been a sustained object of public policy. Rather, the UK has permissive legal forms, leaving a great deal of room for discretion in the adoption of practices of democratic governance, be they forms of shareholder, stakeholder or associative democracy. While more empirical work is needed, current evidence suggests that democratic governance remains a niche practice within economic enterprises, even as the language of mutualism and stakeholding is used to defend policy developments that are reshaping welfare and corporate governance.
Bibliography


